T3 must ring in rule changes

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Competition should replace regulation in Australia's telecommunications sector, argue Joshua Gans and Jerry Hausman.

Economists have a straightforward view towards price regulation: only have it if there isn't enough competition to rely on the market to do the job.

And if you look at economics textbooks, especially Australian ones, telecommunications is held up as a prime example of where we need regulation over market forces. Look at the structure of the Australian telecommunications industry today and for as long as we can remember, it is easy not to question the need for ongoing regulation.

But it was never really the plan for regulation to continue indefinitely. Instead, the plan was to keep Telstra on a leash and protect customers while at the same time providing opportunities for entrants to build up investments, brands and confidence. Those entrants would give Telstra a thumping in long-distance and mobile telephony and then, one day, when technology permitted, would invest backwards and compete with Telstra on the last mile. When that occurred, the regulator's job would be done and it would exit the scene.

The 'stepping stone' theory seems today to be a pipedream. Entrants have come in on long-distance and mobile telephony and stopped. Telstra continues to dominate all aspects of telecommunications.

What's the experience in the US? The courts shattered AT&T's stranglehold on the industry in the early 1980s, giving a leg-up to its competitors in long-distance calls. Those competitors grew up on an equal footing with a divested AT&T and then, in 1996, all bets were off. Mergers have occurred, AT&T as a stand-alone company has disappeared, and then because of the internet, cable television companies - for years also cozy monopolists - entered into telecommunications in earnest. Suddenly it became apparent that most of the US had at least two fixed-line options and the case for ongoing regulation withered away.

Telstra complains about sustained regulation. Smaller players in Australia continue to argue for ongoing regulation. Telstra continues to do the lion's share of investment and it is easy to wonder how it will ever end. And this is despite the fact that two fixed-line networks - the old copper network and the new cable network that carries Foxtel pay TV - run by many Australian households. Telstra owns both.

Australia is perhaps the only large country where a single firm owns both of the key, fixed-line networks. The fact that there are two networks destroys the myth that Telstra is some sort of natural monopolist for whom the costs of separation would outweigh the benefits of competition. The infrastructure necessary for competition is in place and can be economically expanded to cover most of the population. Moreover, it is currently 51.8 per cent owned and controlled by the federal government.

The federal government should force Telstra to divest its cable infrastructure and its interest in Foxtel. In return, it should be allowed to invest in the next generation of broadband technologies without regulatory intervention. Why? Because with the cable network safely in the hands of a competitor who would offer broadband and telephone service, there would be no need for regulation.

The puzzle is that there is no clamour of voices for change. The federal government wants business as usual in an attempt to conserve its ever-diminishing Telstra shareholding valuation. Telstra itself would rather lobby for regulatory relief than consider ways of solving the problem that is causing regulation: the lack of competition. And the regulator is powerless to engage in legal options to force Telstra to divest these assets.

The sale of the third tranche of Telstra offers the opportunity for change. It can be structured to protect current non-public shareholders by having a buyback. At the same time, the regulatory relief will enhance the total value of Telstra - something within the government's power and the public interest.

So when will regulation of telecommunications end? Right now, if you want it. Otherwise, the outcome will be regulation forever. Competition is a superior economic outcome to regulation forever.

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